

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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CC:CORP:B02

PLR-112884-13

Date:

September 10, 2013

### Legend

Distributing =

Controlled =

Shareholder A =

Shareholder B =

Shareholder C =

Date 1 =

Date 2 =

Date 3 =

Month 1 =

Month 2 =

Month 3 =

Month 4 =

Month 5 =

Sub 1 =

Sub 2 =

Sub 3 =

State X =

State Y =

Business A =

Business A1 =

Business A2 =

a =

b =

c =

d =

e =

f =

g =

h =

i =

i =

k =

l =

m =

n =

o =

p =

q =

Dear :

This letter ruling responds to your representative's March 19, 2013 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in subsequent correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a "penalties of perjury" statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the facts, representations, and other information may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Proposed Transaction (as defined below): (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is being used principally as a device for the distribution of earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) of the Internal Revenue Code (the "Code") and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or a series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7).

#### FACTS

Distributing, a privately owned State X corporation, is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing

and the members of its separate affiliated group (“SAG”), as defined in section 355(b)(3)(B) (the “Distributing SAG”), are engaged in Business A.

Distributing has two classes of common stock outstanding—Class A voting common stock and Class B non-voting common stock. The terms of the Class A and Class B stock are identical except with respect to voting rights and certain related rights (e.g., the right to call special meetings and to modify the corporate by-laws). As of Date 1, a shares of Class A stock and b shares of Class B stock were issued and outstanding. Shareholder A owns all of the Class A stock; Shareholder B owns c% of the Class B stock, and Shareholder C owns the remaining d% of the Class B stock. Distributing has no preferred stock outstanding.

Distributing directly owns 100% of the stock of both Sub 1 (a State X limited liability company that is disregarded as separate from Distributing for federal income tax purposes) and Sub 2 (a State X corporation). Sub 1 and its wholly owned subsidiaries (collectively, the “Sub 1 Subgroup”) are engaged in Business A1. Distributing also directly owns approximately e% of Sub 3, a State X corporation that is engaged in Business A2. Sub 3 has two classes of stock outstanding—voting common stock and non-voting preferred stock. As of Date 1, Distributing owned all f shares of the Sub 3 preferred stock and approximately e% of the g outstanding shares of Sub 3 common stock. Various Sub 3 employees (the “Employee Shareholders”) own the remaining h% of Sub 3 common stock.

Distributing has submitted financial information indicating that each of Business A1 and Business A2 has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

As of Date 1, Distributing (or one of its wholly owned subsidiaries that is disregarded as an entity separate from Distributing for federal income tax purposes) had certain outstanding debts, including but not limited to the following: (i) debt totaling \$i that was incurred in Months 1 and 2 to repurchase shares from former shareholders (such shareholders, the “Former Shareholder Lenders,” and such debt, the “Stock Buy-Back Debt”); (ii) debt to Shareholder A of \$j (the “Shareholder Debt”) that was incurred in Month 3; and (iii) a term loan facility with a third-party bank (the “Bank Lender”) of approximately \$k (the “Bank Debt”), which was drawn down in Month 4 to refinance other Distributing obligations.

On Date 2, Sub 3 made a payment of \$l to Distributing as a return of capital. Additionally, on Date 3, Sub 3 paid a regular quarterly dividend on its preferred stock to Distributing in the amount of \$m. Sub 3 may pay an additional dividend on its preferred stock to Distributing prior to the Contribution (as defined below). Distributing also expects to redeem some (but not all) of the Class B shares held by Shareholder B immediately before the Proposed Transaction (as defined below).

## PROPOSED TRANSACTION

For what are represented to be valid business reasons, Distributing has undertaken or proposes to undertake the following transactions pursuant to a single plan (together, the "Proposed Transaction"):

- (1) Distributing formed a new State Y corporation ("Controlled") as a direct, wholly owned subsidiary in Month 5. Controlled has one class of common stock (and no preferred stock) outstanding.
- (2) Distributing will transfer all of its common and preferred Sub 3 stock to Controlled in exchange for approximately e% of Controlled stock (the "Contribution"). At the same time, the Employee Shareholders will transfer all of their Sub 3 common stock to Controlled in exchange for the remaining h% of Controlled stock.
- (3) Distributing will distribute at least n% of Controlled stock to Distributing's shareholders on a pro rata basis (the "Distribution").
- (4) Distributing's shareholders may contribute their shares of Controlled stock to a newly formed limited liability company classified as a partnership for federal income tax purposes ("New LLC") in exchange for membership interests therein.
- (5) Distributing will exchange any retained Controlled stock (which will comprise no more than o% of all outstanding Controlled stock) (the "Retained Controlled Stock") for a portion of the Stock Buy-Back Debt, the Shareholder Debt, and/or the Bank Debt. More specifically:
  - (a) Prior to the Distribution, Distributing will give Shareholder A and the Former Shareholder Lenders the option to enter into exchange agreements pursuant to which Distributing will exchange shares of Controlled stock for an amount of Shareholder Debt and Stock Buy-Back Debt, respectively.
  - (b) Prior to the Distribution, one or more investment banks (the "Investment Banks"), acting as principals for their own account, may purchase a portion of the Bank Debt from the Bank Lender (the "Bank Debt Purchase"). If the Bank Debt Purchase takes place, Distributing will enter into an exchange agreement with the Investment Banks (the "Bank Debt Exchange Agreement") no sooner than five days after the Bank Debt Purchase. Pursuant to the Bank Debt Exchange Agreement, the Investment Banks will exchange an amount of Bank Debt for shares of Controlled stock (the "Bank Debt Exchange"). The Bank Debt Exchange Agreement will provide that the pricing for the exchange will be determined based on the fair market value of the Bank Debt and the

- Controlled stock as of the date of the exchange, and that the exchange will occur at least 14 days after the Bank Debt Purchase.
- (c) The Investment Banks are expected to sign an underwriting agreement with Distributing and Controlled to conduct a public offering (the "IPO") of (i) the Controlled stock (if any) to be acquired by the Investment Banks in the Bank Debt Exchange, (ii) the Controlled stock (if any) to be acquired by the Investment Banks in the Controlled Stock Purchase (see Step 6 below), and (iii) newly issued shares of Controlled stock.
  - (d) Distributing will exchange the Retained Controlled Stock (if any) for an amount of the Shareholder Debt, the Stock Buy-Back Debt, and/or the Bank Debt (the "Debt-for-Equity Exchange"; any such exchanged Distributing debt, the "Distributing Debt"). All Distributing Debt will be retired at face value. The Debt-for-Equity Exchange is expected to occur approximately simultaneously with the Distribution, and it will occur at least 14 days after the Bank Debt Purchase (if the Bank Debt Purchase takes place).
- (6) Immediately following the Debt-for-Equity Exchange, Shareholder A and the Former Shareholder Lenders are expected to sell their shares of Controlled stock received in the Debt-for-Equity Exchange to the Investment Banks for cash (the "Controlled Stock Purchase").
- (7) At least one day after the Distribution, the Investment Banks are expected to issue the Controlled stock described above in Step 5(c) in the IPO. The IPO proceeds will be used by Controlled for general corporate purposes, including capital expenditures, the expansion of markets and services, and the future acquisition of businesses or companies. If Controlled receives more cash in the IPO than is required for these purposes, Controlled may use the excess proceeds to issue a special dividend to its shareholders of record before the IPO.

Following the Proposed Transaction, Distributing and Controlled will operate as two independent companies. Immediately after the Proposed Transaction, a majority of directors on the board of Controlled will be persons that are not directors, officers, employees, or principal shareholders of Distributing. No person will serve as an officer or employee of both Distributing and Controlled after the Proposed Transaction except as described in the following paragraph.

In connection with the Proposed Transaction, Distributing and Controlled (or their subsidiaries) have entered or will enter into certain agreements and arrangements, including a tax-sharing agreement and a transitional services agreement. Pursuant to the transitional services agreement, several Distributing employees will provide certain services (the "Transitional Services") for Controlled at cost for up to 9 months after the Proposed Transaction, and the General Counsel of Distributing will serve as General Counsel of Controlled for up to 9 months after the Proposed Transaction. In addition,

Sub 2 and Sub 3 have entered into a lease agreement with respect to real property (with Sub 2 as landlord and Sub 3 as tenant) on terms intended to reflect arm's-length negotiation, including arm's-length pricing. It is expected that there will be no material changes to the lease following the Proposed Transaction other than the renegotiation of the lease at the end of its term to the prevailing market rate. The foregoing agreements or arrangements concerning the relationship between Distributing and Controlled after the Proposed Transaction are collectively referred to herein as the "Continuing Arrangements."

## REPRESENTATIONS

Distributing has made the following representations in connection with the Proposed Transaction:

- (a) No part of the consideration to be distributed by Distributing in the Distribution will be received by a shareholder of Distributing as a creditor or an employee or in any capacity other than that of a shareholder of Distributing. In addition, the distribution of Controlled stock to Distributing's shareholders in the Distribution is with respect to their ownership of Distributing stock.
- (b) Distributing will treat all members of its separate affiliated group (within the meaning of section 355(b)(3)(B)) ("Distributing SAG") as one corporation in determining whether it meets the requirements of section 355(b)(2)(A) regarding the active conduct of a trade or business.
- (c) Controlled will treat all members of its separate affiliated group (within the meaning of section 355(b)(3)(B)) ("Controlled SAG") as one corporation in determining whether it meets the requirements of section 355(b)(2)(A) regarding the active conduct of a trade or business.
- (d) No intercorporate debt will exist between Distributing (or any member of the Distributing SAG) and Controlled (or any member of the Controlled SAG) at the time of, or subsequent to, the Distribution, other than any debt that arises under the Continuing Arrangements. Any indebtedness owed by Controlled (or any member of the Controlled SAG) to Distributing (or any member of the Distributing SAG) after the Distribution will not constitute stock or securities.
- (e) The five years of financial information submitted by Distributing with respect to each of Business A1 and Business A2 is representative of their present business operations, and with regard to each of Business A1 and Business A2, there have been no substantial operational changes since the date of the last financial statements submitted.

- (f) Neither Business A1 nor control of an entity conducting Business A1 will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the Distribution, the Distributing SAG will have been the principal owner of the goodwill and significant assets of Business A1, and it will continue to be the principal owner following the Distribution.
- (g) Neither Business A2 nor control of an entity conducting Business A2 will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the Distribution, the Distributing SAG will have been the principal owner of the goodwill and significant assets of Business A2, and the Controlled SAG will continue to be the principal owner following the Distribution.
- (h) Following the Distribution, the Distributing SAG will continue the active conduct of Business A1, independently and with its separate employees, except as provided pursuant to the Continuing Arrangements.
- (i) Following the Distribution, the Controlled SAG will continue the active conduct of Business A2, independently and with its separate employees, except as provided pursuant to the Continuing Arrangements.
- (j) The Distribution is being carried out for the following corporate business purposes: (i) enabling Controlled to raise significantly more funds per share in an IPO in order to pursue its business strategies; (ii) providing Controlled with currency in the form of publicly traded stock that may be used to make future acquisitions; (iii) enabling Controlled to implement more effective customized stock-based incentive compensation packages; and (iv) enabling Distributing to reduce its debt by means of the Debt-for-Equity Exchange. The Distribution is motivated, in whole or substantial part, by these corporate business purposes.
- (k) The Distribution is not being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (l) The total adjusted basis and the fair market value of the assets to be transferred to Controlled by Distributing in the Contribution each will equal or exceed the sum of the liabilities to be assumed (within the meaning of section 357(d)), if any, by Controlled plus any liabilities to which the transferred assets are subject.
- (m) The liabilities, if any, to be assumed (within the meaning of section 357(d)) by Controlled in the Contribution and the liabilities to which the transferred assets



are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

- (n) The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the Contribution.
- (o) The fair market value of the assets transferred to Controlled in the Contribution will equal or exceed Controlled's aggregate basis in those assets immediately after the Contribution.
- (p) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.
- (q) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (see Treas. Reg. §§ 1.1502-13 and 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; Treas. Reg. § 1.1502-13 as published by T.D. 8597). Further, any excess loss account of a member in the stock of another member that is required to be taken into account by Treas. Reg. § 1.1502-19 will be included in income as appropriate. At the time of the Distribution, neither Distributing nor any member of Distributing's consolidated group will have an excess loss account in the stock of Controlled or in the stock of any subsidiary of Controlled.
- (r) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (s) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing stock or securities that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

- (t) Payments made in connection with all continuing transactions between Distributing (or any of its subsidiaries) and Controlled (or any of its subsidiaries) following the Distribution will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's-length, except for certain payments made for Transitional Services (which will be provided at cost).
- (u) No two parties to the Distribution are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (v) The Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 1.355-7) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50-percent or greater interest (within the meaning of section 355(d)(4)) in either Distributing or Controlled (including any predecessor of or successor to any such corporation).
- (w) Immediately after the transaction (within the meaning of section 355(g)(4)), either (i) any person that holds a 50-percent or greater interest (within the meaning of section 355(g)(3)) in any disqualified investment corporation (within the meaning of section 355(g)(2)) will have held such an interest in such corporation immediately before the transaction, or (ii) neither Distributing or Controlled is or will be a disqualified investment corporation (within the meaning of section 355(g)(2)).
- (x) Distributing and Controlled, and their respective shareholders, will each pay their own expenses, if any, incurred in connection with the Proposed Transaction.
- (y) The aggregate amount of Distributing Debt exchanged for Controlled stock in the Debt-for-Equity Exchange will not exceed the weighted quarterly average of Distributing debt owed to unrelated third parties for the 12-month period ending at the close of business on the last full business day before the date on which the separation of Business A1 and Business A2 was first presented to Distributing's Board of Directors.
- (z) The Distributing Debt was incurred by Distributing in the ordinary course of business and was not incurred in connection with, or in contemplation of, the Contribution, the Distribution, or the Debt-for-Equity Exchange.
- (aa) Any money, property, or stock contributed by Distributing to Controlled in the Contribution will be exchanged solely for stock or securities in Controlled.
- (bb) No Controlled stock is being distributed in the Distribution in exchange for Distributing stock.

## RULINGS

Based solely on the information submitted and the representations set forth above, and provided that (i) the distribution of Controlled stock to Distributing's shareholders in the Distribution is with respect to their ownership of Distributing stock, (ii) any money, property, or stock contributed by Distributing to Controlled in the Contribution is exchanged solely for stock or securities in Controlled, and (iii) any other transfer of stock, money, or property between Distributing, Controlled, or any Distributing shareholder and any person related to Distributing, Controlled, or any Distributing shareholder is respected as a separate transaction, we rule as follows:

- (1) The Contribution, together with the Distribution, will qualify as a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled each will be a "party to a reorganization" within the meaning of section 368(b).
- (2) Distributing will recognize no gain or loss on the Contribution. Sections 357(a) and 361(a).
- (3) Controlled will recognize no gain or loss on the Contribution. Section 1032(a).
- (4) Immediately after the Contribution, Controlled's basis in each asset received in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the Contribution. Section 362(b).
- (5) Controlled's holding period for each asset received in the Contribution will include the period during which Distributing held that asset. Section 1223(2).
- (6) Distributing will recognize no gain or loss on the Distribution. Section 361(c)(1).
- (7) Distributing will recognize no income, gain, deduction, or loss upon the Debt-for-Equity Exchange, other than any (i) deductions attributable to the redemption of any Distributing Debt at a premium, (ii) income attributable to the redemption of any Distributing Debt at a discount, and (iii) interest expense accrued with respect to the Distributing Debt. Section 361(c).
- (8) Distributing's shareholders will not recognize any gain or loss (and will not otherwise include any amount in income) upon their receipt of Controlled stock in the Distribution. Section 355(a)(1).
- (9) Immediately after the Distribution, the basis in the hands of each Distributing shareholder of the Distributing stock and the Controlled stock that is distributed in the Distribution will equal the basis of the Distributing stock with respect to which the Distribution is made, allocated in proportion to the fair market values of the Distributing and Controlled stock immediately after the Distribution in accordance with Treas. Reg. § 1.358-2(a). Sections 358(a)(1), (b), and (c).

- (10) The holding period of the Controlled stock received by each Distributing shareholder in the Distribution will include the holding period of the Distributing stock with respect to which the Distribution is made, provided the Distributing stock is held as a capital asset on the date of the Distribution. Section 1223(1).
- (11) Earnings and profits will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. §§ 1.312-10(a) and 1.1502-33(e)(3).

### CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Code and the Treasury regulations or the tax treatment of any condition existing at the time of, or effect resulting from, the Proposed Transaction that is not specifically covered by the above Rulings. In particular, no opinion is expressed or implied regarding:

- (i) Whether the Distribution satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b);
- (ii) Whether the Distribution is being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled, or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); or
- (iii) Whether the Distribution and any acquisition or acquisitions are part of a plan (or series of related transactions) under section 355(e)(2)(A)(ii).

### PROCEDURAL STATEMENTS

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Russell G. Jones  
Assistant to the Branch Chief, Branch 2  
Office of Associate Chief Counsel (Corporate)